

# ANALYSIS OF ORIGINAL BILL

## Franchise Tax Board

Author: Burton Analyst: Colin Stevens Bill Number: SB 934  
Related Bills: See Legislative History Telephone: 845-3036 Introduced Date: 2/25/99  
Attorney: Doug Bramhall Sponsor: CA Credit Union League

**SUBJECT:** Exempt Corporations/Adds Credit Unions

### SUMMARY

This bill would allow state-chartered credit unions to qualify for exemption from franchise or income tax under the Bank and Corporation Tax Law (B&CTL) and also would exempt all credit unions from other state, county and municipal taxes and license fees, except certain specified taxes.

### EFFECTIVE DATE

This bill would apply to income years beginning on or after January 1, 1999.

### LEGISLATIVE HISTORY

AB 3117 (1995/96), AB 1413, SB 1873 (1997/98).

### BACKGROUND

#### CREDIT UNIONS

Credit unions are defined under the California Financial Code as a cooperative, organized for the purposes of (1) promoting thrift and savings among its members, (2) creating a source of credit for their members at rates of interest set by the board of directors, and (3) providing an opportunity for members to use and control their own money on a democratic basis in order to improve their economic and social conditions. As a cooperative, a credit union conducts its business for the mutual benefit and general welfare of its members with the earnings, savings, benefits, or services of the credit union being distributed to its members as patrons.

To qualify as a state-chartered credit union, the organization must meet certain statutory requirements and must apply for and receive a certification from the California Commissioner of Corporations.

Under federal law, a federally-chartered credit union is a cooperative association organized under the Federal Credit Union Act and granted a certificate of status by the National Credit Union Administration (NCUA).

A federally-chartered credit union generally is not taxable by states, except for taxes on real property and tangible personal property.

#### Board Position:

<u>      </u> S	<u>      </u> NA	<u>      </u> NP
<u>      </u> SA	<u>      </u> O	<u>      </u> NAR
<u>      </u> N	<u>      </u> OUA	<u>  X  </u> PENDING

#### Department Director

#### Date

**Gerald Goldberg**

**3/25/1999**

## EXEMPT ORGANIZATIONS

The California Corporations Code governs the formation of corporations in California. A corporation may be incorporated as a "for profit" corporation or a "nonprofit" corporation. "For profit" corporations do not qualify for tax-exempt status. California nonprofit corporations are either public benefit corporations, mutual benefit corporations or religious corporations. Nonprofit corporations are not automatically exempt from taxation. A nonprofit corporation must apply for tax-exempt status with the Franchise Tax Board (FTB) and receive a determination exempting the organization from state tax. A tax-exempt corporation incurs a tax liability on its taxable business income unrelated to its exempt purpose.

Federally chartered credit unions are generally not taxable under **federal or state law** by operation of the Federal Credit Union Act. Federal law also provides exemption from the federal income tax for nonprofit organizations that meet certain criteria. If an organization fails to meet those criteria, the Internal Revenue Service (IRS) may deny exempt status or may revoke the exempt status of an organization that no longer meets the criteria. Federal credit unions currently are eligible for federal tax-exempt status.

## SPECIFIC FINDINGS

**Under current law** a state-chartered credit union is considered in substantial competition with national banks and is classified as a financial corporation for state tax purposes and is subject to the franchise tax. However, since credit unions are operated on a cooperative basis, they are allowed a deduction for all the income resulting from or arising out of business activities with their members, as defined, or on a nonprofit basis with nonmembers.

**Current law** defines "surplus member savings capital" as the savings capital of a credit union in excess of the savings capital which is lent to members of the credit union. Income from permitted investments of surplus member savings capital and from reciprocal transactions with member credit unions constitutes income "for or with members" and is deductible from taxable income. Remaining investment income is subject to taxation.

While state chartered credit unions are subject to the franchise tax for state purposes, no minimum tax is imposed (unlike other corporations which must pay a minimum franchise tax of \$800, regardless of income or loss). As a financial corporation, credit unions are subject to the tax rate imposed on banks and other financial corporations, currently set at the franchise tax rate plus the 2% "in-lieu" rate.

**Under both state and federal law** tax-exempt organizations are taxable on their "unrelated business taxable income" (UBTI). UBTI is the gross income derived from any trade or business unrelated to the organization's tax-exempt purpose less directly connected allowable deductions. In addition, income that is attributable to property acquired through debt financing constitutes UBTI, as does certain advertising and insurance income.

**SB 934** would exempt state-chartered credit unions from the income or franchise tax (including the in-lieu rate) under the B&CTL and also would exempt all credit unions from other state, county and municipal taxes and license fees, except certain specified taxes such as real property taxes, sales and use taxes, taxes

on unrelated business income, and motor vehicle license fees. State-chartered credit unions still would be subject to tax on UBTI. However, income earned on investments of surplus member savings capital generally would not be subject to tax on UBTI because it is not debt-financed income.

#### Policy Considerations

This bill would place state-chartered credit unions on a more equal footing with federal credit unions, which generally are exempt from state income/franchise tax.

Credit unions are financial organizations that compete with other types of financial organization (e.g., banks, saving and loan organizations, thrift associations, etc.), which are subject to California tax. By exempting credit unions from franchise tax, income tax, and certain in-lieu taxes, this bill would provide different tax treatment for various financial organizations.

#### Implementation Considerations

Implementation of this bill would not significantly impact the department's programs and operations.

#### Technical Considerations

This bill fails to repeal provisions in B&CTL Section 24405 dealing with credit unions. Department staff is available to assist with the necessary amendments to ensure that this bill and existing sections of law regarding credit unions do not conflict, leading to potential disputes.

Also, this bill would exempt credit unions from a variety of unidentified taxes, which would be referenced in the B&CTL even though these taxes are not administered by the FTB. These exemptions would be more properly located under other provisions of state law.

### FISCAL IMPACT

#### Departmental Costs

This bill would not significantly impact the department's cost of operation.

#### Tax Revenue Estimate

Based on data and assumptions discussed below, this bill would result in the following revenue losses.

Estimated Revenue Impact of SB 934 As Introduced 2/25/99 [\$ In Millions]		
1999-00	2000-01	2001-02
(\$3)	(\$3)	(\$3)

The bill would be effective with income years beginning on or after January 1, 1999, with enactment assumed after June 30.

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

#### Tax Revenue Discussion

The reduction in self-assessed and audit assessed franchise taxes otherwise paid by state-chartered credit unions would determine the revenue impact of this bill.

The estimate is based on state tax return data. For a large sample of state-chartered credit unions, self-assessed taxes were totaled. For the 1996 income year, the tax totaled \$2.8 million.

As exempt organizations under this proposal, credit unions would be subject to unrelated business income tax (UBIT). However, it is unlikely credit unions would have any significant unrelated business income. Any tax revenue that might be derived from UBIT is unknown, but is expected to be very minor.

#### BOARD POSITION

Pending.